



**PUBLIC PROTECTION CABINET
DEPARTMENT OF FINANCIAL INSTITUTIONS**

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April 1, 2011

To: Licensed Mortgage Entities

FROM: Kentucky Department of Financial Institutions

RE: New Examination Procedures

DFI will begin looking at some additional areas during routine compliance examinations of mortgage loan companies and mortgage loan brokers. Management of the financial institution may be asked to provide information not previously requested by examiners. Information such as personnel records, policies and procedures manuals, employee handbooks, and compensation agreements.

The Department's examination process will be largely the same, however examiners will be determining the overall condition of a given licensee based on four general areas: financial condition, compliance, management and consumer services. A brief outline of the four areas follows.

Financial Condition - Licensees should meet the minimum net worth/funding requirements and should have the required surety bond in place. Financial statements will be reviewed to assess the current and historical level of capital, the amount of cash/cash equivalents, mortgage loan receivables (if applicable), real property, and furniture/fixtures. Earnings will be reviewed and compared to previous periods when possible and liquidity will be evaluated to determine if the licensee has the ability to quickly convert some of its assets into cash if necessary and that it has the funding source available to meet present and anticipated funding needs.

Compliance - Licensees should demonstrate incorporation of a compliance culture in their daily operations. Employees should demonstrate understanding and willingness to comply with state laws and federal rules and regulations governing the mortgage industry. It is recommended that the licensee has a designated compliance officer with authority and accountability or an independent compliance review company under contract. Periodic internal audit and quality control review programs should be in place to facilitate the correction of any exceptions found in the loan origination process. Management should routinely review a sample of loans originated by lending personnel and a representative sample of processors and underwriters to confirm that policies are being followed.

Management should also have procedures in place to conduct ongoing due diligence with regard to third-party originators when applicable.

Management - Management controls include the processes and procedures for planning, organizing, directing, and controlling operations. They include the systems for measuring, reporting and monitoring performance. Management's policies and procedures should also ensure adequacy of a company's personnel, training, systems, monitoring, and reporting functions relating to lending transactions. The management component also covers personnel administration. Personnel policies should include processes for hiring and terminating employees in compliance with labor law, the qualifications job candidates must possess for the different types of jobs available in the organization, procedures to protect data from employees that have been terminated, guidance for paying terminated employees for loans that are "in the pipeline", compensation guidelines to attract and retain well qualified individuals, compensation guidelines to avoid incentives for employees to "sell" higher priced loans to consumers who qualify for lower priced loans. It is recommended that the licensee have an employee handbook and a policies and procedures manual. Employee files should contain application information and any performance related documentation. Management should maintain complete and detailed records of past employees. All lending/processing personnel should be properly registered to do business in Kentucky. In the event previous examinations have been conducted, the examiner will also ensure that management responded in a timely manner and that they implemented all changes or corrective measures as indicated in their response. Repeat violations reflect poorly on management.

Consumer Services - The examiner will evaluate management's responses to any consumer complaints received by the Department. Marketing and promotional materials should be in compliance with applicable state and federal laws and should contain unique identifiers when applicable. Marketing and promotional materials should be clear, concise, in a format that is easily interpreted by consumers, and should only reflect rates, terms and programs that are truly available at the time of the solicitation. Management should retain evidence that particular rates or programs were available at the time of the solicitation. All marketing materials used by loan origination personnel should be reviewed by management prior to use. Loan origination activity should be conducted only by properly registered and trained individuals. Origination practices and scripts should be free of unfair or deceptive acts, practices, or statements.

This information will also be posted on our website (www.kfi.ky.gov). If you any questions in regard to this matter please contact Gary Davis at 1-502-429-3290 ext. 237 or GaryM.Davis@ky.gov.